

**PyroGenesis Canada Inc.**  
**Financial Statements**  
*December 31, 2013 and 2012*

# PyroGenesis Canada Inc.

December 31, 2013 and 2012

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## **Management's Responsibility**

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To the Shareholders of PyroGenesis Canada Inc.:

Management is responsible for the preparation and presentation of the accompanying financial statements, including responsibility for significant accounting judgments and estimates in accordance with International Financial Reporting Standards. This responsibility includes selecting appropriate accounting principles and methods, and making decisions affecting the measurement of transactions in which objective judgment is required.

In discharging its responsibilities for the integrity and fairness of the financial statements, management designs and maintains the necessary accounting systems and related internal controls to provide reasonable assurance that transactions are authorized, assets are safeguarded and financial records are properly maintained to provide reliable information for the preparation of the financial statements.

The Board of Directors and Audit Committee are composed primarily of Directors who are neither management nor employees of the Company. The Board of Directors is responsible for overseeing management in the performance of its financial reporting responsibilities, and for approving the financial information included in the annual report. The Board fulfils these responsibilities by reviewing the financial information prepared by management and discussing relevant matters with management and the external auditor. The Audit Committee has the responsibility of meeting with management and the external auditors to discuss the internal controls over the financial reporting process, auditing matters and financial reporting issues. The Committee is also responsible for recommending the appointment of the Company's external auditor.

MNP S.E.N.C.R.L., s.r.l., an independent firm of Chartered Professional Accountants, is appointed by the shareholders to audit the financial statements and report directly to them; their report follows. The external auditor has full and free access to, and meets periodically and separately with, both the Committee and management to discuss their audit findings.

April 30, 2014

*[Signed by P. Peter Pascali]*

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P. Peter Pascali, Chief Executive Officer

*[Signed by Alan Curleigh]*

\_\_\_\_\_  
Alan Curleigh, Chief Financial Officer

## Independent Auditors' Report

To the Shareholders of PyroGenesis Canada Inc.

We have audited the accompanying financial statements of PyroGenesis Canada Inc. ("the Company"), which comprise the statements of financial position as at December 31, 2013 and 2012 and the statements of comprehensive loss, changes in shareholders' deficiency and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

*Management's responsibility for the financial statements:*

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

*Auditors' responsibility:*

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform an audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

*Opinion:*

In our opinion the financial statements present fairly, in all material respects, the financial position of PyroGenesis Canada Inc. as at December 31, 2013 and 2012 and its financial performance and its cash flow for the years then ended in accordance with International Financial Reporting Standards.

*Emphasis of matter – going concern:*

Without qualifying our opinion, we draw attention to Note 1(b) in the financial statements which indicate that the Company incurred a comprehensive loss of \$3,988,077 during the year ended December 31, 2013 and as of that date has an accumulated deficit of \$21,877,797, and the Company's current liabilities exceed its total assets by \$1,373,763. These conditions, along with other matters as set forth in Note 1(b), indicate the existence of a material uncertainty that may cast significant doubt about the Company's ability to continue as a going concern. These financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or amounts and classification of liabilities that may result from the outcome of this uncertainty.

Montréal, Québec

April 30, 2014



<sup>1</sup> CPA Auditor, CA permit No. A119507

# PyroGenesis Canada Inc.

## Statements of Financial Position

As at December 31,	2013 \$	2012 \$
<b>Assets</b>		
<i>Current assets</i>		
Cash	1,182,835	2,195,571
Accounts receivable [note 6]	361,304	157,013
Sales tax receivable	21,809	118,603
Costs in excess of billings [note 7]	286,403	-
Inventories	180,442	-
Investment tax credits receivable	101,938	254,550
Prepaid expenses and deposits [note 8]	112,530	69,391
<b>Total current assets</b>	<b>2,247,261</b>	<b>2,795,128</b>
<b>Non-current assets</b>		
Property and equipment [note 9]	732,788	1,852,845
Intangible assets [note 10]	4,190,823	5,587,896
<b>Total assets</b>	<b>7,170,872</b>	<b>10,235,869</b>
<b>Liabilities</b>		
<i>Current liabilities</i>		
Accounts payable and accrued liabilities [note 11]	1,155,657	1,959,309
Current portion of obligation under finance lease [note 13]	2,763	2,763
Billings in excess of costs and profits on uncompleted contracts [note 14]	2,462,604	2,269,440
<b>Total current liabilities</b>	<b>3,621,024</b>	<b>4,231,512</b>
<b>Non-current liabilities</b>		
Obligation under finance lease [note 13]	6,139	8,896
Loans - other [note 15]	8,153,723	8,449,772
<b>Total liabilities</b>	<b>11,780,886</b>	<b>12,690,180</b>
<b>Shareholders' deficiency [note 16]</b>		
Common shares	13,138,554	12,249,527
Warrants reserve	1,778,999	1,497,948
Contributed surplus	2,325,386	1,663,090
Other equity	24,844	24,844
Deficit	(21,877,797)	(17,889,720)
	<b>(4,610,014)</b>	<b>(2,454,311)</b>
	<b>7,170,872</b>	<b>10,235,869</b>

Going concern disclosure, related party transactions, contingent liability, commitments, subsequent event [notes 1, 19, 22, 25 and 26]

These financial statements were approved and authorized for issuance by the Board of Directors on April 30, 2014.

Approved on behalf of the board:

[Signed by P. Peter Pascali] \_\_\_\_\_ P. Peter Pascali

[Signed by Alan Curleigh] \_\_\_\_\_ Alan Curleigh

The accompanying notes form an integral part of the financial statements.

# PyroGenesis Canada Inc.

## Statements of Comprehensive Loss

Years ended December 31,	2013 \$	2012 \$
<b>Revenue</b>	<b>5,756,009</b>	3,323,236
Cost of sales and services <i>[note 18]</i>	<b>4,530,885</b>	4,841,633
Gross margin	<b>1,225,124</b>	(1,518,397)
<b>Expenses</b>		
Selling, general and administrative <i>[note 18]</i>	<b>4,051,354</b>	3,832,087
Research and development <i>[note 18]</i>	<b>210,977</b>	-
Financing charges	<b>372,126</b>	468,791
	<b>4,634,457</b>	4,300,878
<b>Loss from operations</b>	<b>(3,409,333)</b>	(5,819,275)
Other income	<b>2,894</b>	12,147
Loss on settlement of convertible debenture	-	(2,007)
Impairment loss on property and equipment <i>[note 9]</i>	<b>(581,638)</b>	-
<b>Comprehensive loss</b>	<b>(3,988,077)</b>	(5,809,135)
<b>Basic and diluted loss per share</b>	<b>(0.06)</b>	(0.09)
Weighted average number of common shares outstanding - basic and diluted <i>[note 20]</i>	<b>63,657,005</b>	62,471,907

The accompanying notes form an integral part of the financial statements.

# PyroGenesis Canada Inc.

## Statements of Changes in Shareholders' Deficiency

Years ended December 31, 2013 and 2012

	Number of Class A common shares	Class A common share capital \$	Warrants reserve \$	Contributed surplus \$	Other Equity \$	Deficit \$	Total \$
<b>Balance - December 31, 2012</b>	<b>63,538,649</b>	<b>12,249,527</b>	<b>1,497,948</b>	<b>1,663,090</b>	<b>24,844</b>	<b>(17,889,720)</b>	<b>(2,454,311)</b>
Issuance of common shares <i>[note 16(i)]</i>	3,660,000	1,281,000	-	-	-	-	1,281,000
Fair value warrants <i>[note 16(i)]</i>	-	(336,459)	336,459	-	-	-	-
Brokers' fees – cash payment <i>[note 16(i)]</i>	-	(13,764)	-	-	-	-	(13,764)
Additional legal fees <i>[note 16(i)]</i>	-	(14,595)	-	-	-	-	(14,595)
Additional agent fees <i>[note 16(i)]</i>	-	(27,155)	-	-	-	-	(27,155)
Expired warrants <i>[note 16(ii)]</i>	-	-	(55,408)	55,408	-	-	-
Share-based payments	-	-	-	606,888	-	-	606,888
Comprehensive loss during the year	-	-	-	-	-	(3,988,077)	(3,988,077)
<b>Balance - December 31, 2013</b>	<b>67,198,649</b>	<b>13,138,554</b>	<b>1,778,999</b>	<b>2,325,386</b>	<b>24,844</b>	<b>(21,877,797)</b>	<b>(4,610,014)</b>
<i>Balance – December 31, 2011</i>	59,114,094	10,596,651	110,306	711,035	30,966	(12,080,585)	(631,627)
Issuance of common shares <i>[note 16(iv)]</i>	4,424,555	3,539,644	-	-	-	-	3,539,644
Fair value warrants <i>[note 16(iv)]</i>	-	(1,332,234)	1,332,234	-	-	-	-
Brokers' fees – cash payment <i>[note 16(iv)]</i>	-	(234,000)	-	-	-	-	(234,000)
Additional legal fees <i>[note 16(iv)]</i>	-	(137,239)	-	-	-	-	(137,239)
Additional agent fees <i>[note 16(iv)]</i>	-	(127,887)	-	-	-	-	(127,887)
Broker warrants <i>[note 16(iv)]</i>	-	(55,408)	55,408	-	-	-	-
Share-based payments	-	-	-	952,055	-	-	952,055
Early repurchase of convertible bond <i>[note 16(vii)]</i>	-	-	-	-	(6,122)	-	(6,122)
Comprehensive loss during the year	-	-	-	-	-	(5,809,135)	(5,809,135)
Balance - December 31, 2012	63,538,649	12,249,527	1,497,948	1,663,090	24,844	(17,889,720)	(2,454,311)

The accompanying notes form an integral part of the financial statements.

# PyroGenesis Canada Inc.

## Statements of Cash Flows

Years ended December 31	2013 \$	2012 \$
<b>Cash flows provided by (used in)</b>		
<b>Operating activities</b>		
Comprehensive loss	(3,988,077)	(5,809,135)
Items not requiring an outlay of cash:		
Share-based payments	606,888	952,055
Depreciation on property and equipment [note 9]	205,966	258,951
Accretion of long-term debt	-	15,475
Amortization of intangible assets [note 10]	1,397,073	1,397,073
Impairment loss on property and equipment [note 9]	581,638	-
Loss on repurchase of long-term debt	-	2,007
	(1,196,512)	(3,183,574)
Net change in non-cash operating working capital items [note 17]	(417,170)	3,537,363
	(1,613,682)	353,789
<b>Investing activity</b>		
Purchase of property and equipment [note 9]	(325,734)	(591,127)
<b>Financing activities</b>		
Decrease in bank indebtedness	-	(240,000)
Proceeds from (repayments of) obligation under finance lease	(2,757)	11,659
Increase in loans - other	-	152,743
Repayments of loans - other	(296,049)	(13,407)
Repayment of long-term debt	-	(1,000,000)
Proceeds from issuance of common shares	1,281,000	3,539,644
Costs related to issuance of common shares	(55,514)	(499,126)
	926,680	1,951,513
<b>Increase (decrease) in cash</b>	<b>(1,012,736)</b>	<b>1,714,175</b>
Cash - beginning of year	2,195,571	481,396
<b>Cash - end of year</b>	<b>1,182,835</b>	<b>2,195,571</b>

Supplemental disclosure of expenses and cash flow information [note 17]

The accompanying notes form an integral part of the financial statements.



# PyroGenesis Canada Inc.

## Notes to the Financial Statements

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For the years ended December 31, 2013 and 2012

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### 1. Nature of operations and going concern disclosure

#### (a) Nature of operations

PyroGenesis Canada Inc. (the "Company"), incorporated under the laws of the Canada Business Corporations Act, was formed by the amalgamation of PyroGenesis Canada Inc. with Industrial Growth Income Company ("IGIC") on July 11, 2011. The Company owns patents of advanced waste treatment systems technology and provides design, development, manufacturing and commercialization of advanced plasma processes. The Company is domiciled at 1744 William Street, Suite 200, Montreal, Quebec. The Company is publicly traded on the TSX Venture Exchange under the Symbol "PYR". These financial statements were approved and authorized for issuance by the Board of Directors on April 30, 2014.

#### (b) Going concern

These financial statements have been prepared on the going concern basis, which presumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of business for the foreseeable future.

The Company has incurred recurring losses to date, with \$3,988,077 of losses occurring in 2013 and has an accumulated deficit of \$21,877,797 at December 31, 2013. In addition, the Company's current liabilities exceed its current assets as at December 31, 2013 in the amount of \$1,373,763. These conditions indicate the existence of a material uncertainty that may cast significant doubt on the Company's ability to continue as a going concern.

In the future, it may be necessary for the Company to raise additional capital to fund its operations and continued development and introduction of new products to its family of products. To date, the Company has raised financing through successive issuances of equity. There is no certainty that the Company will continue to be able to raise additional financing or expand its sales to fund its operations.

The financial statements have been prepared on a going concern basis and do not include any adjustments to the amounts and classifications of the assets and liabilities that might be necessary should the Company be unable to achieve its plan and continue in business. If the going concern assumption were not appropriate for these financial statements then adjustments would be necessary to the carrying value of assets and liabilities, the reported expenses and the statements of financial position classifications used. The impact on the financial statements could be material.

### 2. Basis of preparation

#### (a) Statement of compliance:

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"), issued by the International Accounting Standards Board ("IASB").

#### (b) Functional and Presentation Currency

These financial statements are presented in Canadian dollars, which is the Company's functional currency.

#### (c) Basis of measurement

These financial statements have been prepared on the historical cost basis except for the following item in the statements of financial position:

Financial instruments classified as fair value through profit or loss and available for sale are measured at fair value.

# PyroGenesis Canada Inc.

## Notes to the Financial Statements

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For the years ended December 31, 2013 and 2012

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### 3. Significant accounting policies

#### (a) Revenue recognition

Revenues relating to research and equipment contracts are recognized on the percentage-of-completion basis. The degree of completion is assessed based on the proportion of total costs incurred to date, in relation to performance, compared to total costs anticipated to provide the service and other deliverables required under the entire contract. Provisions are made for the entire amount of expected losses, if any, in the period in which they are first determinable. The percentage-of-completion method requires the use of estimates to determine the recorded amount of revenues, costs in excess of billings and billings in excess of costs and profits on uncompleted contracts. Given this estimation process, it is possible that changes in future conditions could cause a material change in the recognized amount of revenues and unbilled work-in-progress and accrued expenses.

Revenue related to engineering services, which are not long term contracts are recognized as the services are performed.

#### (b) Foreign currency translation

Foreign currency balances are translated at year-end exchange rates for monetary items and at historical rates for non-monetary items. Revenues and expenses are translated using average exchange rates prevailing at the time of the transaction. Translation gains or losses are included in the determination of comprehensive loss.

#### (c) Financial instruments

##### **Financial assets**

##### i) Initial recognition

A financial instrument is any contract that gives rise to a financial asset of one party and a financial liability or equity instrument of another party. Financial assets and financial liabilities are recognized on the statements of financial position when the Company becomes a party to the contractual provisions of the instrument. On initial recognition, all financial instruments must be measured at fair value which is the amount of consideration that would be agreed upon in an arm's length transaction between knowledgeable willing parties who are under no compulsion to act. Subsequent to initial recognition, the fair value of financial instruments is dependent on the purpose for which the financial assets were acquired or issued, their characteristics and the Company's designation of such instruments. Transaction costs are included in the initial measurement of financial instruments except financial instruments classified as fair value through profit or loss.

International Accounting Standards ("IAS") 39, *Financial Instruments – Recognition and measurement* require that all financial assets be classified as financial assets at fair value through profit or loss, held-to-maturity, available-for-sale or loans and receivables.

The Company's financial assets include cash, accounts receivable, sales tax receivable, costs in excess of billings and investment tax credits receivable.

# PyroGenesis Canada Inc.

## Notes to the Financial Statements

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For the years ended December 31, 2013 and 2012

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### 3. Significant accounting policies (continued)

#### ii) Subsequent measurement

**Financial assets at fair value through profit or loss:** Financial assets at fair value through profit or loss are measured at fair value, with gains or losses, recorded in the statements of comprehensive loss for the period in which they arise. A financial asset at fair value through profit or loss includes assets held for trading and financial assets that are so designated. Fair-value-through-profit-and-loss ("FVTPL") securities are usually held for a short term and are actively traded.

**Loans and receivables:** Loans and receivable financial assets are measured at amortized cost using the effective interest rate method. Interest income calculated using the effective interest rate method is recorded in financing income in the period in which it arises.

Gains and losses are recognized in the statements of comprehensive loss when these assets are impaired or derecognized.

**Held-to-maturity:** Non-derivative financial assets that are purchased and have a fixed maturity date and which management has the intention and the ability to hold to maturity are classified as held-to-maturity. These instruments are accounted for at amortized cost using the effective interest rate method and charged to income in the period of amortization.

Gains and losses are recognized in the statements of comprehensive loss when the assets are impaired or derecognized.

**Available-for-sale:** Available-for-sale financial assets are non-derivative financial assets and are measured at fair value, except for investments in equity instruments that do not have a quoted market price in an active market, which are measured at cost. Unrealized gains and losses, including the effect of changes in foreign exchange rates, are recognized directly in Other Comprehensive Income. Upon derecognition of the financial asset, the cumulative gains or losses, previously recognized in Accumulated Other Comprehensive Income ("AOCI") are reclassified to net income loss.

As a result, the following classifications were determined:

- i) Cash is classified as financial assets at fair value through profit or loss.
- ii) Accounts receivable, sales tax receivable, costs in excess of billings and investment tax credits receivable are classified as loans and receivables.

#### Financial liabilities

##### i) Initial recognition

IAS 39, *Financial Instruments – Recognition and Measurement* requires that all financial liabilities be classified as: financial liabilities at fair value through profit or loss or other liabilities. Classification is determined at the time of initial recognition. Initially, financial liabilities are recognized at fair value.

The Company's financial liabilities include accounts payable and accrued liabilities, obligation under finance lease and loans-other.

# PyroGenesis Canada Inc.

## Notes to the Financial Statements

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For the years ended December 31, 2013 and 2012

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### 3. Significant accounting policies (continued)

#### ii) Subsequent measurement

**Financial liabilities at fair value through profit or loss:** Financial liabilities at fair value through profit or loss include financial liabilities that are held for trading (acquired for purpose of selling in the near term) or financial instruments that are so designated.

Financial liabilities are measured at fair value. Gains and losses on liabilities held-for-trading are recognized in the statements of comprehensive loss.

**Financial liabilities at amortized cost:** Financial liabilities classified as other liabilities are measured at amortized cost using the effective interest method. Interest expense is recorded in financing expense in the period.

As a result, the following classifications were determined:

Accounts payable and accrued liabilities, obligation under finance lease, and loans-other including interest payable, are classified as other liabilities.

#### (d) Impairment of financial assets

At each reporting date the carrying amounts of financial assets, other than those to be measured at fair value through profit or loss, are assessed to determine whether there is objective, significant evidence of impairment (e.g. a debtor is facing serious financial difficulties, or there is a substantial change in the technological, economic, legal or market environment of the debtor). For equity instruments, a significant or prolonged decline in fair value is objective evidence for a possible impairment. The Company has defined criteria for the significance and duration of a decline in fair value.

The amount of the impairment loss on loans and receivables is measured as the difference between the carrying amount of the asset and the present value of estimated future cash flows (excluding expected future credit losses that have not been incurred), discounted at the original effective interest rate of the financial asset. The amount of the impairment loss is recognized in profit or loss. If, in a subsequent reporting period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed and recognized in profit or loss. The impairment loss on loans and receivables is recorded using an allowance account. The decision to account for credit risk using an allowance account or by directly reducing the receivable depends on the estimated probability of the loss of receivables. When receivables are assessed as uncollectible, the impaired asset is derecognized.

If an available-for-sale financial asset is impaired, the difference between its cost (net of any principal payment and amortization) and its current fair value, less any impairment loss previously recognized in the statements of comprehensive loss is reclassified from direct recognition in equity to the statements of comprehensive loss. Reversals with respect to equity instruments classified as available-for-sale are not recognized in the statements of comprehensive loss. A reversal of an impairment loss on a debt instrument is reversed through the statements of comprehensive loss if the increase in fair value of the instrument can be objectively related to an event occurring after the impairment loss is recognized in income.

# PyroGenesis Canada Inc.

## Notes to the Financial Statements

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For the years ended December 31, 2013 and 2012

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### 3. Significant accounting policies (continued)

#### (e) Offsetting financial instruments

Financial assets and liabilities are offset and the net amount presented in the statements of financial position if, and only if, the Company has a legal right to offset the amounts and there is an intention to either settle on a net basis or to realize the assets and settle the liabilities simultaneously.

#### (f) Inventories

Inventories, which are comprised of finished goods, are valued at the lower of cost and net realizable value. Cost is determined by the specific identification method. Cost comprises all costs of purchases, costs of conversion and other costs incurred in bringing inventories to their present location and condition. The cost of items of inventories that are segregated for specific projects is assigned by using specific identification of their individual costs. Net realizable value is the estimated selling price in the ordinary course of business, less estimated costs of completion and selling costs. The Company recognized \$96,937 as an expense during the period on sold inventories. The Company did not recognize any write-downs on inventories or reversals of any previous write-downs during the periods presented.

#### (g) Deferred taxes

##### i) Current tax

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted by the statements of financial position date.

##### ii) Deferred tax

The Company follows the liability method for calculating deferred taxes. Differences between the amounts reported in the financial statements and the tax bases are applied to tax rates in effect to calculate the deferred tax asset or liability. The effect of any change in income tax rates is recognized in the current period income. Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realized or the liability is settled, based on tax rates and tax laws that have been enacted or substantively enacted by the statements of financial position date. Discounting of deferred tax assets and liabilities is not permitted. Deferred tax assets and liabilities are offset if a legally enforceable right exists to offset current tax assets against current tax liabilities and the deferred taxes related to the same taxable entity and the same taxation authority. Deferred tax is provided in full for all temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements, except when the temporary differences arise from the initial recognition of goodwill, or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.

#### (h) Loss per share

The Company presents basic loss per share data for its common shares. Basic loss per share is computed by dividing net loss by the weighted average number of common shares outstanding during the year. Diluted loss per share is computed similarly to basic earnings per share, except that the weighted average number of shares outstanding is increased to include shares from the assumed exercise of stock options and warrants, if dilutive. The number of additional shares is calculated by assuming that outstanding share options and warrants were exercised and that the proceeds from such exercises were used to acquire common shares at the average market price during the year.

# PyroGenesis Canada Inc.

## Notes to the Financial Statements

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For the years ended December 31, 2013 and 2012

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### 3. Significant accounting policies (continued)

#### (i) Property and equipment

Property and equipment are measured at cost less accumulated depreciation and accumulated impairment losses if applicable. Cost includes expenditures that are directly attributable to the acquisition of the asset.

When major parts of an item of property and equipment have different useful lives, they are accounted for separately.

Property and equipment are amortized from the acquisition date.

Depreciation is calculated using the following method and rates:

Computer hardware	declining balance	45%
Computer software	declining balance	50%
Machinery	declining balance	20%
Leasehold improvements	straight line over 5 years	
Equipment under finance lease	straight line over 5 years	

Depreciation methods, useful lives and residual values are reviewed at each financial year-end and adjusted prospectively if appropriate.

Gains and losses on derecognition (on disposal or when it is determined that there are no future economic benefits) of property and equipment are determined by comparing the net disposal proceeds with the carrying amount of property, plant and equipment, and are recognized in the statements of comprehensive loss in the period of derecognition.

#### (j) Impairment - non-financial assets

The carrying amounts of the Company's non-financial assets are assessed at each reporting date to determine whether there is an indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated.

The recoverable amount of an asset or cash-generating unit (CGU) is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Assets that cannot be tested individually are grouped into the smallest independent group of assets that generate cash inflows from continuing use.

An impairment loss is recognized if the carrying amount of an asset or its CGU exceeds its recoverable amount. Impairment losses are recognized in the statement of comprehensive loss. Impairment losses recognized in respect of the CGU are allocated first to reduce the carrying amount of goodwill allocated to the units, and then to reduce the carrying amounts on a pro-rata basis of the other assets in the unit.

Impairment losses recognized in prior periods are assessed at each reporting date as to whether there are any indications that the previously recognized losses may no longer exist or may be decreased. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognized for the asset in prior years.

#### (k) Government assistance and investment tax credits

Investment tax credits are comprised of scientific research and experimental development tax credits. Government assistance and investment tax credits are recognized when there is reasonable assurance of their recovery using the cost reduction method. Investment tax credits are subject to the customary approvals by the pertinent tax authorities. Adjustments required, if any, are reflected in the year when such assessments are received.

# PyroGenesis Canada Inc.

## Notes to the Financial Statements

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For the years ended December 31, 2013 and 2012

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### 3. Significant accounting policies (continued)

#### (l) Intangible assets

Acquired intangible assets are measured at cost on initial recognition. Following initial recognition, intangible assets are carried at cost less any accumulated amortization and any accumulated impairment losses.

Intangible assets with finite lives are amortized over the useful life of the asset and assessed for impairment whenever there is an indication of impairment. The amortization period and method for an intangible asset with a finite life is reviewed at least at each financial year end. Changes in useful life or consumption are accounted for by changing the amortization period or method, and are treated prospectively as changes in accounting estimates. Amortization expense on the intangible assets with finite lives is recognized in the statements of comprehensive loss.

Gains or losses arising from derecognition are recognized in the statements of comprehensive loss at the time that the asset is derecognized.

Intangible assets represent the value of licences that were acquired from a related party.

The estimated useful life of the licence acquired is between 5 - 10 years. Amortization is calculated on a straight line basis over the life of the asset.

#### (m) Research and development costs

Research costs are charged to comprehensive loss in the year they are incurred, net of related investment tax credits. Development costs are charged to comprehensive loss in the year they are incurred net of related investment tax credits unless they meet specific criteria related to technical, market and financial feasibility in order to be recognized as an intangible asset:

- the technical feasibility of completing the intangible asset so that it will be available for use or sale;
- its intention to complete and its ability to use or sell the asset;
- how the asset will generate future economic benefits;
- the availability of resources to complete the asset; and
- the ability to measure reliably the expenditure during development.

Amortization of the asset begins when development is complete. During the period of development, the asset is tested annually for impairment.

#### (n) Provisions

Provisions are recognized when the Company has a present obligation as a result of a past event, it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. The present value of expected future cash outflows is recognized as a liability and the increase to the liability due to the passage of time is recorded as a finance expense.

#### (o) Warranty provision

At the time of sale, a warranty cost is recorded. The warranty provision is based on management's estimate of the expected number of warranty claims and the expected cost of these claims. The warranty provision is based on past experience and on the nature of the contract and is reviewed each reporting date by management. Should these estimates differ materially from actual warranty costs, the Company may incur costs that differ from the provision. Such costs are recorded in cost of sales and services.

#### (p) Leases

Leases where the Company assumes substantially all the risks and rewards of ownership are classified as finance leases. At the commencement of the lease, the leased property is measured at the lower of its fair value and the present value of the minimum lease payments.

Lease payments are apportioned between finance charges and reduction of the outstanding liability to produce a constant periodic rate of interest on the remaining balance of the liability.

# PyroGenesis Canada Inc.

## Notes to the Financial Statements

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For the years ended December 31, 2013 and 2012

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### 3. Significant accounting policies (continued)

Operating lease payments are expensed in the statements of comprehensive loss on a straight line basis over the lease term.

#### (q) Joint operations

The Company conducts some of its activities through interests in jointly controlled assets and operations where it has a direct ownership interest in and it jointly controls the assets and/or operations. The Company recognizes its proportionate share of the income, expenses, assets, and liabilities of these jointly controlled assets and/or operations in the financial statements.

#### (r) Share-based payments

The Company applies a fair value based method of accounting to all share-based payments. Employee and director stock options are measured at their fair value of each tranche on the grant date and recognized in its respective vesting period. Non-employee stock options are measured based on the service provided to the reporting date and at their then-current fair values. The cost of stock options is presented as share-based payment expense when applicable. On the exercise of stock options, share capital is credited for the consideration received and for the fair value amounts previously credited to contributed surplus. The Company uses the Black-Scholes option-pricing model to estimate the fair value of share-based payments.

#### (s) Segment reporting

In accordance with IFRS 8, Operating Segments, it is mandatory for the Company to present and disclose segmental information based on the internal reports that are regularly reviewed by the Board of Directors in order to assess each segment's performance. In this regard, the Company conducts its business in a single operating segment providing design, development, manufacturing and commercialization of advanced plasma processes.

### 4. Significant accounting judgments, estimates and assumptions

The preparation of financial statements requires management to make judgments, estimates and assumptions based on currently available information that affect the reported amounts of assets, liabilities and contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Estimates and judgments are continuously evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. However, actual results could differ from those estimated. By their very nature, these estimates are subject to measurement uncertainty and the effect of any changes in estimates on the financial statements of future periods could be material.

In the process of applying the Company's accounting policies, management has made the following judgments, estimates, and assumptions which have the most significant effect on the amounts recognized in the financial statements:

#### Judgments

##### (a) Jointly controlled operations

Jointly controlled operations involve the use of assets and other resources of the partners rather than the establishment of a separate entity. Each partner uses its own assets, incurs its own expenses and liabilities, and raises its own financing. Each partner recognises in its financial statements the assets that it controls, the liabilities and expenses that it incurs, and its share of the income from the sale of goods or services by the joint operation. There is significant judgment involved in determining whether the Company is involved in a joint operation or a joint venture.

##### (b) Going concern

The assessment of the Company's ability to execute its strategy by funding future working capital requirements involves judgment. Estimates and assumptions are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. There is a material uncertainty regarding the Company's ability to continue as a going concern.



# PyroGenesis Canada Inc.

## Notes to the Financial Statements

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For the years ended December 31, 2013 and 2012

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### 4. Significant accounting judgments, estimates and assumptions (continued)

#### Estimates

##### (a) Revenue recognition

Revenues relating to research and equipment contracts are recognized on the percentage-of-completion basis. The degree of completion is assessed based on the proportion of total costs incurred to date, in relation to performance, compared to total costs anticipated to provide the service and other deliverables required under the entire contract. Provisions are made for the entire amount of expected losses, if any, in the period in which they are first determinable. The percentage-of-completion method requires the use of estimates to determine the recorded amount of revenues, costs in excess of billings and billings in excess of costs and profits on uncompleted contracts. Given this estimation process, it is possible that changes in future conditions could cause a material change in the recognized amount of revenues and unbilled work-in-progress and accrued expenses.

##### (b) Warranty provision

At the time of sale, a warranty provision is recorded. The warranty provision is based on management's estimate of expected number of warranty claims and the expected cost of these claims. The warranty provision is based on past experience and on the nature of the contract and is reviewed each reporting date by management. Should these estimates differ materially from actual warranty costs, the Company may incur costs that differ from the provision. Such costs are recorded in cost of sales and services.

##### (c) Stock-based payments

The Company uses the fair value method of valuing compensation expense associated with the Company's stock option plan. Estimating fair value requires determining the most appropriate valuation model for a grant of equity instruments, which is dependent on the terms and conditions of the grant. This also requires determining the most appropriate inputs to the valuation model including the expected life of the option, volatility, expected forfeitures and distribution yield. The assumptions and models are discussed in Note 16.

##### (d) Assessment of impairment

The Company's impairment test for the intangible assets is based on the value in use calculation, which uses a discounted cash flow model. Cash flows are derived from budgets for the next five years. The recovered amount is most sensitive to the discount rate that is used for the discounted cash flow model, as well as expected future cash inflows and the growth rate. Those estimates may differ from actual values, and the differences may be significant and could have a material impact on the Company's financial position and results of operations. Assets are reviewed for an indication of impairment at each statement of financial position date and when there are indicators of impairment. This determination requires significant judgment. Factors which could trigger an impairment review include, but are not limited to, significant negative industry or economic trends or significant declines in expected sales, earnings or cash flows.

##### (e) Useful lives of property and equipment

The Company estimates the useful lives of property and equipment based on the period over which the assets are expected to be available for use. The estimated useful lives of property and equipment are reviewed periodically and are updated if expectations differ from previous estimates due to physical wear and tear and legal or other limits on the use of the relevant assets. In addition, the estimation of the useful lives of property and equipment are based on management's experience with similar assets. It is possible, however, that future results of operations could be materially affected by changes in the estimates brought about by changes in factors mentioned above. The amounts and timing of recorded expenses for any period would be affected by changes in these factors and circumstances. A reduction in the estimated useful lives of the property and equipment would increase the recorded expenses and decrease the non-current assets. Useful lives, depreciation rates and residual values are reviewed at least annually as required by IFRS.

##### (f) Assessment of Investment tax credits

The investment tax credits are estimated by Management based on quantitative and qualitative analysis and interpretation of various government programmes, related restrictions, limitations, definitions, and eligibility conditions. Management involves its technical staff and external specialists in determining if the expenditures meet the requirements of the different tax credit claims.

# PyroGenesis Canada Inc.

## Notes to the Financial Statements

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For the years ended December 31, 2013 and 2012

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### 4. Significant accounting judgments, estimates and assumptions (continued)

#### (g) Fair value disclosure

The Company's financial assets and liabilities measured at fair value on a recurring basis include the Company's cash. The Company also discloses the fair value of other financial instruments not measured at fair value. The fair value of financial instruments reflects the Company's best estimates of market value based on generally accepted valuation techniques or models and are supported by observable market prices and rates. When such values are not available, the Company uses discounted cash flow analysis from applicable yield curves based on observable market inputs to estimate fair value.

### 5. Adopted and future accounting policies

#### (a) New standards, interpretations and amendments adopted on January 1, 2013

##### *IFRS 11 – Joint Arrangements*

IFRS 11 requires a venturer to classify its interest in a joint arrangement as a joint venture or joint operation. Joint ventures will be accounted for using the equity method of accounting whereas for a joint operation, the venturer will recognize its share of the assets, liabilities, revenue and expenses of the joint operation. Under previous IFRS, entities had the choice to proportionately consolidate or equity account for interests in joint ventures. IFRS 11 supersedes IAS 31, Interest in Joint Ventures, and SIC-13, Jointly Controlled Entities-Non-monetary Contributions by Venturers. There was no impact to the Company's financial statements upon adoption of this standard.

##### *IFRS 12 – Disclosures of Interests in Other Entities*

IFRS 12 establishes disclosure requirements for interests in other entities, such as joint arrangements, associates, special purpose vehicles and off balance sheet vehicles. The standard carries forward existing disclosures and also introduces significant additional disclosure requirements that address the nature of, and risk associated with, an entity's interests in other entities. There was no impact to the Company's financial statements upon adoption of this standard.

##### *IFRS 13 – Fair Value Measurement*

Under previous IFRS, guidance on measuring and disclosing fair value was dispersed among specific standards requiring fair value measurements. IFRS 13 is a comprehensive standard for fair value measurement and disclosure requirements for use across all IFRS standards. This new standard clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between participants, at the measurement date. It also establishes disclosures about fair value measurement. The adoption of IFRS 13 did not require any adjustments to the valuation techniques used by the Company to measure fair value and did not result in any measurement adjustments as at January 1, 2013.

##### *Amendments to IAS 1 – Financial Statement Presentation*

The amendments to IAS 1 require entities to separate items presented in other comprehensive income ("OCI") into two groups, based on whether or not they may be recycled to profit or loss in the future. Items that will not be recycled such as remeasurements related to IAS 19 will be presented separately from items that may be recycled in the future, such as deferred gains and losses on cash flow hedges. Entities that chose to present OCI items before tax will be required to show the amount of tax related to the two groups separately. There was no impact to the Company's financial statements upon adoption of this standard.

##### *IAS 16 – Property, Plant and Equipment*

The amendments clarify that spare parts, stand-by equipment and servicing equipment should be classified as property, plant and equipment when they meet the definition of property, plant and equipment in IAS 16 and as inventory otherwise. There was no impact to the Company's financial statements upon adoption of this standard.

# PyroGenesis Canada Inc.

## Notes to the Financial Statements

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For the years ended December 31, 2013 and 2012

### 5. Adopted and future accounting policies (continued)

#### (b) Recent accounting pronouncements and amendments not yet effective

The Company has not yet applied the following new standards, interpretations and amendments to standards that have been issued as at December 31, 2013 but are not yet effective. Unless otherwise stated, the Company does not plan to early adopt any of these new or amended standards and interpretations.

##### *IFRS 2 – Share-based payment*

The amendments to IFRS 2, issued in December 2013, clarify the definition of “vesting conditions”, and separately define a “performance condition” and a “service condition”. A performance condition requires the counterparty to complete a specified period of service and to meet a specified performance target during the service period. A service condition solely requires the counterparty to complete a specified period of service. The amendments are effective for share-based payment transactions for which the grant date is on or after July 1, 2014.

##### *IFRS 7 – Financial instruments: disclosures and IAS 32 Financial instruments: presentation*

Financial assets and financial liabilities may be offset, with the net amount presented in the statement of financial position, only when there is a legally enforceable right to set off and when there is either an intention to settle on a net basis or to realize the asset and settle the liability simultaneously. The amendments to IAS 32, issued in December 2011, clarify the meaning of the offsetting criterion “currently has a legally enforceable right to set off” and the principle behind net settlement, including identifying when some gross settlement systems may be considered equivalent to net settlement. The amendments will only affect disclosure and are effective for annual periods beginning on or after January 1, 2014.

##### *IFRS 8 – Operating segments*

The amendments to IFRS 8, issued in December 2013, require an entity to disclose the judgments made by management in applying the aggregation criteria for reportable segments. The amendments will only affect disclosure and are effective for annual periods beginning on or after July 1, 2014.

##### *IAS 16 – Property, plant and equipment*

The amendments to IAS 16 and IAS 38, issued in December 2013, clarify how an entity calculates the gross carrying amount and accumulated depreciation when a revaluation is performed. The amendments are effective for annual periods beginning on or after July 1, 2014.

##### *IFRS 9 – Financial instruments*

IFRS 9 introduces new requirements for the classification and measurement of financial assets. IFRS 9 requires all recognized financial assets that are within the scope of IAS 39 – *Financial Instruments: Recognition and Measurement* to be measured at amortized cost or fair value in subsequent accounting periods following initial recognition. Specifically, financial assets that are held within a business model whose objective is to collect the contractual cash flows that are solely payments of principal and interest on the principal outstanding are generally measured at amortized cost at the end of subsequent accounting periods. All other financial assets including equity investments are measured at their fair values at the end of the subsequent accounting periods.

Requirements for classification and measurement of financial liabilities were added in October 2010 and they largely carried forward existing requirements in IAS 39, *Financial Instruments – Recognition and Measurement*, except that fair value changes due to credit risk for liabilities designated at fair value through profit or loss would generally be recorded in other comprehensive income.

IFRS 9 was amended in November 2013, to (i) include guidance on hedge accounting, (ii) allow entities to early adopt the requirement to recognize changes in fair value attributable to changes in an entity's own credit risk, from financial liabilities designated under the fair value option, in OCI, without having to adopt the remainder of IFRS 9, and to (iii) remove the previous mandatory effective date for adoption of January 1, 2015. The standard was later amended to introduce a new mandatory effective date for adoption of January 1, 2018 with early adoption permitted.

# PyroGenesis Canada Inc.

## Notes to the Financial Statements

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For the years ended December 31, 2013 and 2012

### 5. Adopted and future accounting policies (continued)

#### *IAS 24 – Related party disclosures*

The amendments to IAS 24, issued in December 2013, clarify that a management entity, or any member of a group of which it is a part, that provides key management services to a reporting entity, or its parent, is a related party of the reporting entity. The amendments also require an entity to disclose amounts incurred for key management personnel services provided by a separate management entity. This replaces the more detailed disclosure by category required for other key management personnel compensation. The amendments will only affect disclosure and are effective for annual periods beginning on or after July 1, 2014.

#### *IAS 36 – Impairment of assets*

The amendments to IAS 36, issued in May 2013, require:

- Disclosure of the recoverable amount of impaired assets; and
- Additional disclosures about the measurement of the recoverable amount when the recoverable amount is based on fair value less costs of disposal, including the discount rate when a present value technique is used to measure the recoverable amount.

The amendments will only affect disclosure and are effective for annual periods beginning on or after January 1, 2014.

#### *IAS 39 – Financial Instruments: Recognition and measurement*

The amendments to IAS 39, issued in June 2013, clarify that notation of a hedging derivative to a clearing counterparty as a consequence of laws or regulations or the introduction of laws or regulations, does not terminate hedge accounting. The amendments are effective for annual periods beginning on or after January 1, 2014.

#### *IFRIC 21 – Levies*

In May 2013, the IASB issued IFRIC 21, which is effective for annual periods beginning on or after January 1, 2014, with earlier adoption permitted. Within IFRIC 21, a levy is defined as an outflow of resources embodying economic benefits that is imposed by governments on entities in accordance with legislation (i.e. laws and/or regulations), other than:

- those outflows of resources that are within the scope of other standards (such as income taxes that are within the scope of IAS 12); and
  - fines or other penalties that are imposed for breaches of the legislation.
- ‘Government’ refers to government, government agencies and similar bodies whether local, national or international. IFRIC 21 provides an interpretation of the requirements in IAS 37 for the recognition of liabilities for obligations to pay levies that are within the scope of IFRIC 21.

The Company is evaluating whether IFRIC 21 will have a significant impact on the Company's financial statements.

# PyroGenesis Canada Inc.

## Notes to the Financial Statements

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For the years ended December 31, 2013 and 2012

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### 6. Accounts receivable

Accounts receivable are carried on the statements of financial position net of an allowance for doubtful accounts. This allowance is established based on the Company's best estimates regarding the ultimate recovery of balances for which collection is uncertain. Uncertainty of ultimate collection may become apparent from various indicators, such as a deterioration of the credit situation of a given client and delay in collection beyond the contractually agreed upon payment terms. Management regularly reviews accounts receivable, monitors past due balances and assesses the appropriateness of the allowance for doubtful accounts. No amounts are impaired at December 31, 2013 and December 31, 2012.

Details of accounts receivable were as follows:

	2013	2012
	\$	\$
1 – 30 days	315,486	28,610
30 – 60 days	4,500	8,856
61 – 90 days	20,745	10,702
Greater than 90 days	19,505	8,827
Total	360,236	56,995
Receivable from partner in joint operation	-	74,487
Other receivable	1,068	25,531
	<b>361,304</b>	<b>157,013</b>

### 7. Costs in excess of billings

The Company had one contract in which the billings in the year were less than the total costs incurred and recognized profits of \$658,187 as at December 31, 2013 (2012 - \$Nil) see [Note 12].

### 8. Prepaid expenses

	2013	2012
	\$	\$
Deposits	57,530	46,666
Prepaid expenses	55,000	22,725
	<b>112,530</b>	<b>69,391</b>

# PyroGenesis Canada Inc.

## Notes to the Financial Statements

For the years ended December 31, 2013 and 2012

### 9. Property and equipment

	Computer hardware \$	Computer software \$	Machinery \$	Torch asset under construction \$	Leasehold improvements \$	Equipment under finance lease \$	Total \$
Cost:							
Balance at December 31, 2012	157,594	203,114	1,545,260	925,417	67,903	14,326	2,913,614
Additions	5,153	6,173	-	314,408	-	-	325,734
Disposals	-	-	-	(1,239,825) <sup>(i)</sup>	-	-	(1,239,825)
Balance at December 31, 2013	162,747	209,287	1,545,260	-	67,903	14,326	1,999,523
Accumulated depreciation :							
Balance at December 31, 2012	(135,540)	(167,163)	(750,674)	-	(2,865)	(4,527)	(1,060,769)
Depreciation	(11,084)	(19,519)	(158,917)	-	(13,581)	(2,865)	(205,966)
Balance at December 31, 2013	(146,624)	(186,682)	(909,591)	-	(16,446)	(7,392)	(1,266,735)
Net book value	16,123	22,605	635,669	-	51,457	6,934	732,788

(i) Torch asset under construction was sold during the year to the other partner in the joint operation [note 12]. The asset was assessed for impairment and \$581,638 (2012 – \$Nil) was charged to comprehensive loss.

	Computer hardware \$	Computer software \$	Machinery \$	Torch asset under construction \$	Leasehold improvements \$	Equipment under finance lease \$	Total \$
Cost:							
Balance at December 31, 2011	155,229	202,883	1,545,260	419,115	-	-	2,322,487
Additions	2,365	231	-	506,302	67,903	14,326	591,127
Balance at December 31, 2012	157,594	203,114	1,545,260	925,417	67,903	14,326	2,913,614
Accumulated depreciation :							
Balance at December 31, 2011	(118,462)	(131,328)	(552,028)	-	-	-	(801,818)
Depreciation	(17,078)	(35,835)	(198,646)	-	(2,865)	(4,527)	(258,951)
Balance at December 31, 2012	(135,540)	(167,163)	(750,674)	-	(2,865)	(4,527)	(1,060,769)
Net book value	22,054	35,951	794,586	925,417	65,038	9,799	1,852,845

# PyroGenesis Canada Inc.

## Notes to the Financial Statements

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For the years ended December 31, 2013 and 2012

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### 10. Intangible assets

Intangible assets consist of the following:

	Intellectual property \$
<b>2013</b>	
<hr/>	
Cost:	
Balance at December 31, 2012 and 2013	8,409,051
<hr/>	
Accumulated amortization:	
Balance at December 31, 2012	(2,821,155)
Amortization	(1,397,073)
<hr/>	
Balance at December 31, 2013	(4,218,228)
<hr/>	
Net book value	4,190,823
<hr/>	
<b>2012</b>	
<hr/>	
Cost:	
Balance at December 31, 2011 and 2012	8,409,051
<hr/>	
Accumulated amortization:	
Balance at December 31, 2011	(1,424,082)
Amortization	(1,397,073)
<hr/>	
Balance at December 31, 2012	(2,821,155)
<hr/>	
Net book value	5,587,896
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# PyroGenesis Canada Inc.

## Notes to the Financial Statements

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For the years ended December 31, 2013 and 2012

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### 11. Accounts payable and accrued liabilities

	2013 \$	2012 \$
Accounts payable trade	471,466	592,215
Accrued liabilities	550,522	811,276
Accounts payable to a company under common control	-	51,625
Accounts payable - shareholder	29,537	149,213
Accounts payable - trust beneficially owned by a shareholder	104,132	137,489
Accounts payable - partner in joint operation	-	217,491
	<b>1,155,657</b>	<b>1,959,309</b>

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### 12. Joint operation

In 2011, the Company entered into an agreement with another company to share costs, benefits and risks associated with the development of a pilot plasma destruction unit.

Prior to December 14, 2013, the Company had a 50% share in the joint operation. The activities to date have been the design, construction, assembly, commissioning and testing of the pilot plasma destruction unit which was included in Property and equipment in Note 9, as Torch asset under construction.

On December 14, 2013, the Company entered into an agreement, whereby the Company agreed to sell its 50% ownership share in the pilot plasma destruction unit and related receivables and payables to its joint operation partner for a sum of \$750,000, of which \$600,000 is payable in 2014 upon the achievement of established milestones. At December 14, 2013, the asset was transferred from Property and equipment to Inventory, and an impairment loss of \$581,638 was recorded prior to the transfer. In addition, revenues and cost of sales of \$658,187, and costs in excess of billings of \$286,403 were recorded at the time of sale.

### 13. Obligation under finance lease

The finance lease relates to a photocopier. The term of the lease is 60 months. At the end of the lease term, the Company has the option to purchase the asset for \$10. The current lease will be automatically renewed for successive one year periods at current prevailing rates unless cancelled in writing by either party at least 30 days prior to the end of the current term.

	2013 \$	2012 \$
Obligation under finance lease payable in equal quarterly instalments of \$784.59 including interest at 3.534%, due October 1, 2016, with the photocopier, having a net book value of \$6,934 (2012– \$9,799), pledged as collateral.	9,415	12,553
Less: Interest	513	894
	<b>8,902</b>	<b>11,659</b>
Less: current portion	2,763	2,763
	<b>6,139</b>	<b>8,896</b>

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# PyroGenesis Canada Inc.

## Notes to the Financial Statements

For the years ended December 31, 2013 and 2012

### 14. Billings in excess of costs and profits on uncompleted contracts

The amount to date of costs incurred and recognized profits less recognized losses for construction projects in progress amounted to \$4,528,715 (2012 - \$1,004,033).

Payments received on contracts in progress were \$6,741,319 (2012 - \$3,273,473).

Amounts billed and not yet received on contracts in progress of \$250,000 (2012 - \$Nil) are included in accounts receivable.

### 15. Loans – other

	2013 \$	2012 \$
Balance of sale - company under common control (i)	7,771,698	7,889,861
Amounts payable - trust beneficially owned by a shareholder (ii)	382,025	359,911
Promissory note payable - company controlled by a shareholder (iii)	-	200,000
	<b>8,153,723</b>	<b>8,449,772</b>
Current portion	-	-
	<b>8,153,723</b>	<b>8,449,772</b>

- (i) Balance of sale – company under common control is payable in monthly instalments of \$40,000 from April 1, 2011 until December 31, 2040 with interest at an implicit rate of 4.753% per annum. The implicit rate of interest was based on the present value of cash flows having the same value as the intangible assets at the time of sale. The fair value of the intangible assets was based on an external independent valuation.

The face value of the balance of sale at December 31, 2013 was \$13,438,416 (\$13,906,591 in 2012).

During 2012, the \$40,000 monthly instalments were not paid. On February 1, 2012, the Company signed an amending agreement to amend the terms and conditions of the balance of sale. Based on the amending agreement, payments for the period starting February 1, 2012 and ending February 1, 2013 had been postponed to March 31, 2014 except for a payment of \$130,000 to be made before March 31, 2013. The unpaid amount of interest during 2012 was added back to the balance of sale – company under common control in the amount of \$342,625.

Furthermore in the February 1, 2012 amending agreement, each instalment for the period starting March 1, 2013 and ending March 1, 2014 was reduced to \$20,000 and the balance of each of these instalments would become due and payable on March 31, 2014.

During 2013, instalment payments were made according to the February 1, 2012 amending agreement with the exception of the \$20,000 instalment payable October 1, 2013 which was not paid.

On December 16, 2013, the Company signed another amending agreement to amend the terms and conditions of the balance of sale – company under common control. Based on the new amendment, each instalment for the period starting on October 1, 2013 and ending on May 1, 2014 will be completely deferred until April 1, 2015 except for a payment of \$178,175 to be made on or before December 31, 2013 and for a payment of \$30,000 to be made on or before January 31, 2014.

Furthermore, each instalment for the period starting on June 1, 2014 and ending on May 1, 2015 will be reduced to \$20,000 and the balance of these instalments will become due and payable on April 1, 2015.

However, in the event that the Company should conclude a financing in excess of \$3,000,000 before April 1, 2015, all deferred amounts will become immediately due and payable on the closing date of the financing. Additionally, in the event of any change within the Company that would be considered material by the holder of the balance of sale, such as a change in management, any and all amounts outstanding will become immediately due and payable on the date of the material change notwithstanding whether due or not at that date.

# PyroGenesis Canada Inc.

## Notes to the Financial Statements

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For the years ended December 31, 2013 and 2012

### 15. Loans – other (continued)

- (ii) Amounts payable - trust beneficially owned by a shareholder are unsecured, bear interest at 6% and are not repayable before July 1, 2015. However, in the event that the Company should conclude a financing in excess of \$3,000,000 before July 1, 2015, the full amount will become immediately due and payable on the closing date of the financing.
- (iii) Promissory note payable – was repaid on December 18, 2013.

### 16. Shareholders' equity

#### *Authorized:*

The Company is authorized to issue an unlimited number of Class A common shares without par value.

#### *Issues during 2013:*

- (i) On December 20, 2013, the Company completed a private placement in which 3,660,000 units were issued at a price of \$0.35 each for gross proceeds of \$1,281,000. Each unit consisted of one common share and one share purchase warrant exercisable at the strike price of \$0.55 per common share until December 20, 2015. In the event that the volume weighted average price of the common shares on the TSX Venture Exchange is equal to or greater than \$1.00 for a period of twenty (20) consecutive days, then the exercise period of the warrants will be reduced to 30 days from the first day following such 20-day period.

In accordance with the Black Scholes pricing model, the Company has allocated a value of \$0.092 to each purchase warrant for a total value of \$336,459 which has been credited to warrants reserve. The following assumptions under the Black Scholes model were used to arrive at this fair value.

Risk free interest rate	1.11%
Expected volatility	102%
Expected dividend yield	Nil
Expected life	2 years

Share issue costs associated with this transaction of \$55,514 were paid in cash.

- (ii) On March 29, 2013, the broker warrants issued with the private placement that occurred on March 29, 2012 expired.
- (iii) The Company has a stock option plan authorizing the Board of Directors to grant options to directors, officers, employees and consultants to acquire common shares of the Company at a price computed by reference to the closing market price of the shares of the Company on the business day before the Company notifies the stock exchanges of the grant of the option. The number of shares which may be granted to any one person shall not exceed 5% (2% for consultants) of total share capital over a twelve month period.

On May 30, 2013, 100,000 options with an exercise price of \$0.22 per share were granted. These options vest over one year starting on the date of grant. The value of each option under the Black Scholes pricing model is \$0.057 for a total fair value of \$5,342 of which \$4,445 has been expensed and credited to contributed surplus in the current year. The following assumptions under the Black Scholes model were used to arrive at the fair value:

Risk free interest rate	1.41%
Expected volatility	102%
Expected dividend yield	Nil
Expected life	5 years
Exercise price	\$0.22
Forfeiture rate	5%

# PyroGenesis Canada Inc.

## Notes to the Financial Statements

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For the years ended December 31, 2013 and 2012

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### 16. Shareholders' equity (continued)

*Issues during 2012:*

- (iv) On March 29, 2012, the Company completed an equity offering for a total of 4,424,555 Class A common shares at a price of \$0.80 per share for net proceeds of \$3,040,518 after a cash commission paid to the agents of \$234,000, additional agent fees of \$127,887 and legal fees of \$137,239. Each unit is comprised of one Class A common share of the Company and one common share purchase warrant. Each warrant will entitle the holder to purchase one common share at a price of \$1.20 per Class A common share which can be exercised until March 29, 2015.

In accordance with the Black Scholes pricing model, the Company has allocated a value of \$0.301 to each warrant for a total value of \$1,332,234 which has been credited to warrants reserve. The following assumptions under the Black Scholes model were used to arrive at fair value:

Risk free interest rate	1.31%
Expected volatility	127%
Expected dividend yield	Nil
Expected life	3 years

On closing, the agents received 309,719 warrants at a price of \$0.80 which can be exercised until March 29, 2013.

In accordance with the Black Scholes pricing model, the Company has allocated a value of \$0.179 to each warrant for a total value of \$55,408 which has been credited to warrants reserve. The following assumptions under the Black Scholes model were used to arrive at fair value:

Risk free interest rate	1.07%
Expected volatility	128%
Expected dividend yield	Nil
Expected life	1 year

- (v) On March 30, 2012, the broker warrants issued with the private placement that occurred on March 30, 2011 expired.

# PyroGenesis Canada Inc.

## Notes to the Financial Statements

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For the years ended December 31, 2013 and 2012

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### 16. Shareholders' equity (continued)

#### (vi) Stock option

On September 19, 2012, 160,000 options with an exercise price of \$0.15 per share were granted. These options vest over three years starting on the date of grant. The value of each option under the Black Scholes pricing model is \$0.16 for a total fair value of \$23,535 of which \$9,263 in 2013, (\$8,377 in 2012) has been expensed and credited to contributed surplus. The following assumptions under the Black Scholes model were used to arrive at the fair value:

Risk free interest rate	1.41%
Expected volatility	136.0%
Expected dividend yield	Nil
Expected life	5 years
Exercise price	\$0.15
Forfeiture rate	5%

On September 19, 2012, 550,000 options with an exercise price of \$0.175 per share were granted. These options vest over two to three years starting on the date of grant. The value of each option under the Black Scholes pricing model is \$0.16 for a total fair value of \$77,728 of which \$32,464 in 2013, (\$34,137 in 2012) has been expensed and credited to contributed surplus. The following assumptions under the Black Scholes model were used to arrive at the fair value:

Risk free interest rate	1.41%
Expected volatility	136.0%
Expected dividend yield	Nil
Expected life	5 years
Exercise price	\$0.175
Forfeiture rate	5%

On September 19, 2012, 100,000 options with an exercise price of \$0.80 per share were repriced so that the exercise price was \$0.15. These options vest over two years starting on the date of grant. The value of each option under the Black Scholes pricing model is \$0.16. The fair value of the options under the old exercise price at September 19, 2012 was \$0.12 which resulted in an incremental fair value difference of \$0.04 for a total fair value of \$3,853 of which \$1,162 in 2013, (\$2,399 in 2012) has been expensed and credited to contributed surplus. The following assumptions under the Black Scholes model were used to arrive at the fair value:

Risk free interest rate	1.41%
Expected volatility	136.0%
Expected dividend yield	Nil
Expected life	5 years
Exercise price	\$0.15
Forfeiture rate	5%

On November 19, 2012, 1,166,000 options with an exercise price of \$0.21 per share were granted. These options vest over three years starting on the date of grant. The fair value of each option under the Black Scholes pricing model is \$0.18 for a total fair value of \$189,736 of which \$81,910 in 2013, (\$33,059 in 2012) has been expensed and credited to contributed surplus. The following assumptions under the Black Scholes model were used to arrive at the fair value:

Risk free interest rate	1.32%
Expected volatility	137.0%
Expected dividend yield	Nil
Expected life	5 years
Exercise price	\$0.21
Forfeiture rate	5%

# PyroGenesis Canada Inc.

## Notes to the Financial Statements

For the years ended December 31, 2013 and 2012

### 16. Shareholders' equity (continued)

On November 19, 2012, 2,100,000 options with an exercise price of \$0.80 per share were repriced so that the exercise price was \$0.21. These options vest over two years starting on the date of grant. The fair value of each option under the Black Scholes pricing model is \$0.18. The fair value of the options under the old exercise price at November 19, 2012 was \$0.12 which resulted in an incremental fair value difference of \$0.04 for a total value of \$79,619 of which \$35,474 in 2013, (\$31,585 in 2012) has been expensed and credited to contributed surplus. The following assumptions under the Black Scholes model were used to arrive at the fair value:

Risk free interest rate	1.32%
Expected volatility	137.0%
Expected dividend yield	Nil
Expected life	5 years
Exercise price	\$0.21
Forfeiture rate	5%

In 2012, the Company also revised the forfeiture rate estimate to 5% from a former estimate of 2%.

(vii) On April 16, 2012, the Company exercised its right under the loan agreement with FIER Croissance Durable ("FCD") and repurchased the convertible bond that was included in long-term debt in the prior year.

### Stock option plan

The option activity, under the share option plan and information concerning outstanding and exercisable options, is as follows:

	Options issued	Weighted Average exercise price \$
Balance – December 31, 2011	3,100,000	0.80
Options granted	1,876,000	0.20
Options forfeited	(400,000)	0.80
Options repriced	2,200,000	0.21
Options cancelled and repriced	(2,200,000)	0.80
Balance – December 31, 2012	4,576,000	0.27
Options granted	100,000	0.22
Options forfeited	(162,000)	0.28
Balance – December 31, 2013	4,514,000	0.27

# PyroGenesis Canada Inc.

## Notes to the Financial Statements

For the years ended December 31, 2013 and 2012

### 16. Shareholders' equity (continued)

As at December 31, 2013, the outstanding options, as issued under the stock option plan to directors, officers, employees and consultants for the purchases of one common share per option, are as follows:

Outstanding	Exercisable	Weighted averaged exercise price	Expiry date
530,000	318,000	0.800	July 2016
550,000	315,000	0.175	September 2017
210,000	128,000	0.150	September 2017
3,124,000	1,572,200	0.210	November 2017
100,000	50,000	0.220	May 2018
4,514,000	2,383,200	0.272	

### Warrants

At December 31, 2013, the following exercisable warrants were outstanding:

	Granted	Exercisable	Weighted average exercise price	Expiry date
Balance – December 31, 2011	355,827	355,827	\$0.80	March 30, 2012
Expired	(355,827)	(355,827)	\$0.80	
Broker warrants issued	309,719	309,719	\$0.80	March 29, 2013
Warrants issued	4,424,555	4,424,555	\$1.20	March 29, 2015
Balance – December 31, 2012	4,734,274	4,734,274	\$1.17	
Expired	(309,719)	(309,719)	\$0.80	
Warrants issued	3,660,000	3,660,000	\$0.55	December 20, 2015
Balance – December 31, 2013	8,084,555	8,084,555	\$0.91	

### 17. Supplemental disclosure of expenses and cash flow information

(i) Net changes in non-cash components of operating working capital	2013 \$	2012 \$
<b>Decrease (increase) in:</b>		
Accounts receivable	(397,178)	1,001,837
Sales tax receivable	96,794	(54,072)
Costs in excess of billings	150,000	-
Inventories	(180,442)	-
Investment tax credits receivable	152,612	1,689,968
Prepaid expenses and deposits	(43,139)	(18,869)
<b>Increase (decrease) in:</b>		
Accounts payable and accrued liabilities	(388,981)	(625,044)
Billings in excess of costs and profits on uncompleted contracts	193,164	1,543,543
	<b>(417,170)</b>	<b>3,537,363</b>

# PyroGenesis Canada Inc.

## Notes to the Financial Statements

For the years ended December 31, 2013 and 2012

### 17. Supplemental disclosure of expenses and cash flow information (continued)

#### (ii) Interest and income taxes paid:

	2013 \$	2012 \$
Interest paid	-	117,731
Income taxes	-	-

#### (iii) Disclosure of non-cash transactions

On December 14, 2013, the Company sold its 50% ownership share in the torch asset under construction to its partner in the joint operation for a sum of \$750,000, of which \$600,000 is payable in 2014 upon the achievement of established milestones [Note 12]. The sale resulted in the settlement of accounts receivable of \$192,886 and accounts payables of \$414,671. The asset with a cost of \$658,187 was transferred from Property and equipment to Inventory, and an impairment loss of \$581,638 was recorded prior to the transfer. In addition, costs in excess of billings of \$286,403, net of \$150,000 actually received, were also recorded at the time of sale.

On December 20, 2013, the Company completed a share offering which included attached warrants with a fair value of \$336,459. This transaction was recorded in equity [Note 16].

On March 29, 2012, the Company completed a share offering which included attached warrants with a fair value of \$1,332,234 and broker warrants with a fair value of \$55,408. These transactions were recorded in equity [Note 16].

On April 16, 2012, the Company exercised its right under a loan agreement with FIER Croissance Durable ("FCD") to repurchase a convertible bond. An amount of \$6,122 was assessed as the fair value of the convertible rights at the date of repurchase. The Company also incurred a loss on repurchase of the debt of \$2,007.

During the year ended December 31, 2012, property and equipment at an aggregate cost of \$14,326 was acquired by means of a finance lease.

### 18. Other information

Cost of sales and services includes the following items:

	2013 \$	2012 \$
Amortization of intangible assets	1,397,073	1,397,073
Employee compensation	705,509	1,393,062
Investment tax credits	(169,711)	(361,324)
Subcontracting	50,012	660,035
Direct materials	2,139,308	1,100,125
Utilities	96,777	137,221
Rent	176,409	367,109
Government grants	-	(29,113)
Other expenses	135,508	177,445
	<b>4,530,885</b>	<b>4,841,633</b>

# PyroGenesis Canada Inc.

## Notes to the Financial Statements

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For the years ended December 31, 2013 and 2012

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### 18. Other information (continued)

Selling, general and administrative includes the following items:

	2013 \$	2012 \$
Depreciation on property and equipment	205,966	258,951
Share-based payments	606,888	952,055
Employee compensation	2,061,938	1,267,275
Office and general	278,607	354,079
Professional fees	527,771	567,941
Travel	113,805	241,999
Other expenses	256,379	189,787
	<b>4,051,354</b>	<b>3,832,087</b>

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Research and development includes the following items:

	2013 \$	2012 \$
Employee compensation	287,259	-
Subcontracting	46,134	-
Materials and equipment	27,445	-
Government grants	(150,864)	-
Other expenses	1,003	-
	<b>210,977</b>	<b>-</b>

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### 19. Related party transactions

Rent was charged by a trust beneficially owned by a shareholder of the Company in the amount of \$107,903 (2012 - \$112,682). A balance due of \$104,132 (2012 - \$157,565) is included in accounts payable and accrued liabilities.

Interest on amounts payable was charged by a trust beneficially owned by a shareholder of the Company in the amount of \$22,113 (2012 - \$20,809). The balance of interest that has not been paid of \$101,942 (2012 - \$79,829) is included in loans - other.

Interest on balance of sale was charged by a company under common control in the amount of \$350,012 (2012 - \$356,034).

Rent of \$Nil (2012 - \$330,000) was charged by a company under common control. A balance due of \$Nil (2012 - \$51,625) is included in accounts payable and accrued liabilities.

Fees of \$60,673 were charged by directors (2012 - \$Nil). A balance of \$22,167 (2012 - \$3,576) is included in accounts payable and accrued liabilities.

Total compensation to key management consisted of salaries of \$846,837 (2012 - \$735,075), pension contributions of \$8,527 (2012 - \$6,769) and share-based payments granted in the year with a fair value of \$Nil (2012 - \$206,700). A balance of \$44,264 (2012 - \$243,768) is included in accounts payable and accrued liabilities.



# PyroGenesis Canada Inc.

## Notes to the Financial Statements

For the years ended December 31, 2013 and 2012

### 20. Loss per share

Basic loss per share amounts are calculated by dividing net loss for the year attributable to common shareholders by the weighted average number of common shares outstanding during the year.

The net loss and weighted average number of common shares used in the calculation of loss per share are as follows:

	2013 \$	2012 \$
<b>Net loss for the year</b>	<b>(3,988,077)</b>	<b>(5,809,135)</b>
Weighted average number of Class A common shares - basic and diluted	63,657,005	62,471,907
<b>Basic and diluted loss per share</b>	<b>(0.06)</b>	<b>(0.09)</b>

The diluted weighted average number of shares is calculated assuming the proceeds that arise from the exercise of outstanding and in the money options and warrants are used to purchase Class A common shares of the Company at their average market price for the period. For the year ended December 31, 2013 and 2012, potential shares from all outstanding options and warrants have been excluded from the calculation of diluted loss per share as their inclusion is considered anti-dilutive in periods when a loss is incurred.

### 21. Financial instruments

As part of its operations, the Company carries a number of financial instruments. It is management's opinion that the Company is not exposed to significant interest, currency or credit risks arising from these financial instruments except as otherwise disclosed. The Company's overall risk management program focuses on the unpredictability of the financial market and seeks to minimize potential adverse effects on the Company's financial performance. The Company does not use derivative financial instruments to hedge these risks.

#### Foreign currency risk

The Company enters into transactions denominated in US Dollars for which the related revenues, expenses, accounts receivable and accounts payable and accrued liabilities balances are subject to exchange rate fluctuations.

As at December 31, 2013, the following items are denominated in foreign currencies

	US \$	CDN \$
Cash	67,841	72,178
Accounts payable and accrued liabilities	(96,482)	(101,308)
<b>Total</b>	<b>(28,641)</b>	<b>(29,130)</b>

# PyroGenesis Canada Inc.

## Notes to the Financial Statements

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For the years ended December 31, 2013 and 2012

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### 21. Financial instruments (continued)

As at December 31, 2012, the following items are denominated in foreign currencies:

	US \$	CDN \$
Cash	2,119,220	2,112,114
Accounts receivable	3,286	3,286
Accounts payable and accrued liabilities	(80,695)	(81,097)
Total	2,041,811	2,034,303

Foreign currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. Management has implemented a policy to manage foreign exchange risk by using its purchases in U.S. dollars as a natural hedge against its revenue stream. Therefore the Company does not hold derivative financial instruments to manage the fluctuation of exchange rate risk.

#### Sensitivity analysis

At December 31, 2013, if the US Dollar changes by 10% against the Canadian dollar with all other variables held constant, the impact on after-tax loss for the year would have been \$2,900 (2012 – \$204,200).

#### Credit concentration

As at December 31, 2013, three customers accounted for 90% (2012 – four customers for 93%) of revenues from operations and two customers accounted for 89% (2012 – three customers for 68%) of the accounts receivable, representing the Company's major credit risk exposure. The Company believes that there is no unusual exposure associated with the collection of these receivables. The Company manages its credit risk by performing credit assessments of its customers and provides allowances for potentially uncollectible accounts receivable. The Company does not generally require collateral or other security from customers on accounts receivable.

#### Fair value of financial instruments

Financial instruments comprise of cash, accounts receivable, sales tax receivable, costs in excess of billings, investment tax credits receivable, accounts payable and accrued liabilities, obligation under finance lease and loans-other. There are three levels of fair value that reflect the significance of inputs used in determining fair values of financial instruments:

Level 1 — quoted prices (unadjusted) in active markets for identical assets or liabilities

Level 2 — inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices)

Level 3 — Inputs for the asset or liability that are not based on observable market data

The fair values of cash, accounts receivable, sales tax receivable, costs in excess of billings, investment tax credits receivable, accounts payable and accrued liabilities, and current portion of obligation under finance lease approximate their carrying amounts due to their short-term maturities.

# PyroGenesis Canada Inc.

## Notes to the Financial Statements

For the years ended December 31, 2013 and 2012

### 21. Financial instruments (continued)

The classification of financial instruments at their carrying amount and fair values is as follows:

2013	Carrying value			Fair value
	Fair value through profit or loss \$	Available for sale \$	Loans and receivables \$	Total \$
Financial assets:				
Cash	1,182,835	-	-	1,182,835
Accounts receivable	-	-	361,304	361,304
Sales tax receivable	-	-	21,809	21,809
Costs in excess of billings	-	-	286,403	286,403
Investment tax credit receivable	-	-	101,938	101,938
	1,182,835	-	771,454	1,954,289

2013	Carrying value		Fair value
	Fair value through profit or loss \$	Other liabilities \$	Total \$
Financial liabilities:			
Accounts payable and accrued liabilities	-	1,155,657	1,155,657
Loans - other	-	8,153,723	7,242,025
Obligation under finance lease	-	8,902	8,902
	-	9,318,282	8,406,584

2012	Carrying value			Fair value
	Fair value through profit or loss \$	Available for sale \$	Loans and receivables \$	Total \$
Financial assets:				
Cash	2,195,571	-	-	2,195,571
Accounts receivable	-	-	157,013	157,013
Sales tax receivable	-	-	118,603	118,603
Investment tax credit receivable	-	-	254,550	254,550
	2,195,571	-	530,166	2,725,737

# PyroGenesis Canada Inc.

## Notes to the Financial Statements

For the years ended December 31, 2013 and 2012

### 21. Financial instruments (continued)

2012	Carrying value		Fair value
	Fair value through profit or loss \$	Other liabilities \$	Total \$
Financial liabilities:			
Accounts payable and accrued liabilities	-	1,959,309	1,959,309
Loans - other	-	8,449,772	7,669,911
Obligation under finance lease	-	11,659	11,659
	-	10,420,740	9,640,879

The fair value of financial assets traded in active markets that are based on quoted market prices at the close of trading, which consists of cash, are classified as Level 1. A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency and those prices represent actual and regularly occurring market transactions on an arm's length basis. The quoted market price used for financial assets held by the Company is the current bid price.

The fair value of financial assets and liabilities not traded in active markets that are based on unobservable inputs are classified as Level 3. A fair value measurement developed using a present value technique might be categorized within Level 3, depending on the inputs that are significant to the entire measurement and the level of the fair value hierarchy within which those inputs are categorized. If an observable input requires an adjustment using an unobservable input and that adjustment results in a significantly higher or lower fair value measurement, the resulting measurement would be categorized within Level 3 of the fair value hierarchy. The Company's Level 3 liability consists of an interest-free balance of sale - company under common control ("balance of sale") (presented under "loans — other"). The main inputs for the Company's internally developed valuation for its interest-free balance of sale include:

- principal repayment schedule of the balance of sale;
- the principal (or most advantageous) market for the balance of sale;
- perspective of market participants at the measurement date;
- an estimate of future cash flows to (installments to be paid to) the holder of the balance of sale;
- expectations about possible variations in the amount and timing of the cash flows representing the uncertainty inherent in the timing of future principal repayments on the balance of sale;
- the time value of money, represented by the rate on risk-free monetary assets that have maturity dates or durations that coincide with the period covered by the cash flows and pose neither uncertainty in timing nor risk of default by the Company;
- the price for bearing the uncertainty inherent in timing and repayment of the balance of sale (i.e. a risk premium);
- typical discount rate for credit risk, default risk, liquidity risk and other concerns associated with debt investments.

The valuation technique makes the maximum use of market inputs and relies as little as possible on entity-specific inputs. The valuation technique appropriately considers the availability of data with which to develop inputs that represent the assumptions that market participants would use when pricing the asset and the level of the fair value hierarchy within which the inputs are categorized. Some of the inputs to the valuation model may not be market observable. Credit rating and financial position information for the Company may or may not be published or available. Accordingly, the fair value determination of the balance of sale follows a level 3 valuation methodology.

# PyroGenesis Canada Inc.

## Notes to the Financial Statements

For the years ended December 31, 2013 and 2012

### 21. Financial instruments (continued)

The Company uses a present value technique to estimate the fair value of the balance of sale. The Company uses expected cash flows (i.e., installment amounts) that are not risk-adjusted and a discount rate adjusted to include the risk premium that market participants require. The discount rate used for this technique is derived from observed rates of return for comparable assets or liabilities that are traded in the market. Accordingly, the most likely installment schedule is discounted at an observed or estimated market rate. Under the valuation method used by the Company, the expected installments are not adjusted for market risk. Rather, the adjustment for that risk is included in the discount rate. Thus, the expected installments are discounted at an expected rate of return of 6.192% (5.908% in 2012) (equivalent to the average yield on corporate bonds deemed to have a similar credit rating and a maturity date in our about 2040, yielding a fair value of approximately \$6,860,000 (\$7,110,000 in 2012) for the balance of sale.

The aggregate fair value of the balance of sale decreases by approximately \$570,000 (\$620,000 in 2012) for every 1% increment in the discount rate and increases by approximately \$660,000 (\$710,000 in 2012) for every 1% decrement in the discount rate.

The income approach (i.e., a present value technique that takes into account the future cash flows that a market participant would expect to receive from holding the debt instrument as an asset) was used to determine the fair value of the balance of sale. The market approach (i.e., using prices and other relevant information generated by market transactions involving identical liabilities) and the cost approach (i.e., the amount that would be required currently to extinguish the liability) could not be used to determine the fair value of the balance of sale. The output of a model is always an approximation of a value that cannot be determined with certainty. Accordingly, the valuation technique employed may not fully reflect all factors relevant to the liabilities the Company has.

#### Interest rate risk

Interest rate risk is the risk that the value of a financial instrument might be adversely affected by a change in interest rates. Changes in market interest rates may have an effect on the cash flows associated with some financial assets and liabilities, known as cash flow risk, and on the fair value of other financial assets or liabilities, known as price risk. The Company is not exposed to an interest rate risk as it has no debt at a variable interest rate.

#### Liquidity risk

Liquidity risk is the risk that the Company will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivery of cash or another financial asset. The Company's ability to continue as a going concern is dependent on management's ability to raise required funding through future equity issuances and to generate positive cash flows from operations. The Company manages its liquidity risk by forecasting cash flows from operations and anticipating any investing and financing activities. Management and the Board of Directors are actively involved in the review, planning and approval of significant expenditures and commitments.

The following table summarizes the contractual maturities of financial liabilities as at December 31, 2013:

Financial liability	Total	Less than 1 year	1-3 years	Over 3 years	With no specific maturity
Accounts payable and accrued liabilities	1,155,657	1,155,657	-	-	-
Loans - other	8,153,723	-	1,289,505	6,864,218	-
Obligation under finance lease	8,902	2,763	6,139	-	-
	9,318,282	1,158,420	1,295,644	6,864,218	-

# PyroGenesis Canada Inc.

## Notes to the Financial Statements

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For the years ended December 31, 2013 and 2012

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### 21. Financial instruments (continued)

The following table summarizes the contractual maturities of financial liabilities as at December 31, 2012.

Financial liability	Total	Less than 1 year	1-3 years	Over 3 years	With no specific maturity
Accounts payable and accrued liabilities	1,959,309	1,959,309	-	-	-
Loans - other	8,449,772	-	1,435,697	7,014,075	-
Obligation under finance lease	11,659	2,763	8,896	-	-
	<u>10,420,740</u>	<u>1,962,072</u>	<u>1,444,593</u>	<u>7,014,075</u>	<u>-</u>

### 22. Contingent liability

The Company had received a government grant in prior years of approximately \$800,000 to assist with the development of a new system of advanced waste treatment systems technology.

The grant is potentially repayable at the rate of 3% of any consideration received as a result of the project, for which funding has been received, to a maximum of the actual grant received. This will be in effect for 10 years beginning 3 years after the completion date of the new system which was on May 30, 2011.

### 23. Capital management

The Company's objectives in managing capital are:

- To ensure sufficient liquidity to support its current operations and execute its business plan; and
- To provide adequate return to the shareholders

The Company's primary objectives when managing capital is to ensure the entity continues as a going concern as well as to maintain optimal returns to shareholders and benefits for other stakeholders.

The Company currently funds these requirements from cash flows from operations and with financing arrangements with shareholders. The Company is not subject to any externally imposed capital requirements.

The management of capital includes common shares, warrants reserve and contributed surplus for a total amount of \$17,242,939 (2012 - \$15,410,565) and debt of \$8,162,625 (2012 - \$8,461,431). The Company monitors its working capital in order to meet its financial obligations. As at December 31, 2013, the Company's working capital was calculated as a deficiency of \$1,373,763 (2012 – deficiency of \$1,436,384).

# PyroGenesis Canada Inc.

## Notes to the Financial Statements

For the years ended December 31, 2013 and 2012

### 24. Income taxes

#### (a) Reconciliation of income taxes

The impact of differences between the Company's reported income taxes on operating loss and the expense that would otherwise result from the application of statutory rates is as follows:

	2013	2012
	\$	\$
Loss before income taxes	<b>(3,988,077)</b>	(5,809,135)
Income tax rates	<b>26.90%</b>	26.90%
Income tax recovery at the combined basic Federal and Provincial tax rates	<b>(1,072,793)</b>	(1,562,657)
Permanent differences	<b>246,410</b>	242,879
Change in tax rates	-	40,879
Share issue costs	<b>(152,398)</b>	(149,170)
Other	<b>(23,766)</b>	65,201
Change in deferred tax benefits not recognized	<b>1,002,547</b>	1,362,868
<b>Income tax expense</b>	<b>-</b>	<b>-</b>

#### (b) The tax effects of significant items comprising the Company's net deferred tax assets and liabilities are as follows:

	2013	2012
	\$	\$
Share issue costs	<b>211,790</b>	288,440
Tax cost of property and equipment and intangible assets in excess of carrying value	<b>657,931</b>	304,568
Loans-other discounted to fair value	<b>(1,524,346)</b>	(1,618,499)
Non-capital losses carried forward	<b>3,980,769</b>	3,429,953
Other	<b>84,001</b>	3,136
	<b>3,410,145</b>	2,407,598
Deferred tax assets not recognized	<b>(3,410,145)</b>	(2,407,598)
	<b>-</b>	<b>-</b>

# PyroGenesis Canada Inc.

## Notes to the Financial Statements

For the years ended December 31, 2013 and 2012

### 24. Income taxes (continued)

(c) Tax carry forward

The Company has the following non-capital losses available to reduce future income taxes:

<b>Expiry date</b>	<b>Federal \$</b>	<b>Provincial \$</b>
2027	318,662	1,556,210
2028	229,804	1,020,579
2030	2,056,478	2,896,315
2031	5,128,653	4,535,702
2032	3,945,870	4,092,314
2033	2,047,643	2,047,642
	<b>13,727,110</b>	<b>16,148,762</b>

The Company has a total of \$1,182,233 of federal ITCs that can be carried forward for 20 years and expire from 2028 to 2033.

### 25. Commitments

(a) Premises

The Company has entered into long-term leases for premises. The leases end between January 2017 and August 2017. The minimum lease payments due over the next five years are as follows:

	<b>\$</b>
2014	300,899
2015	307,700
2016	314,500
2017	149,156
	<b>1,072,255</b>

Included in the above are commitments to a trust beneficially owned by a shareholder of the Company of \$108,913 for the years 2014 through 2016 and \$9,076 for 2017.

### 26. Subsequent event

On April 22, 2014, the Company announced that it has entered into an agreement with an agent to undertake a private placement at a price of \$0.60 per unit for gross proceeds of approximately \$3,000,000. Each unit will be composed of one common share and one-half of one common share purchase warrant. The warrant will entitle the holder to purchase one common share at the price of \$0.85. The warrants will expire 18 months following the closing date and will be subject to accelerated expiry provisions, such that if at any time after the completion of the hold period, the closing price of the common shares on the TSX Venture is at least \$1.20 per common share for a period of 20 consecutive trading days, the Company may accelerate the expiry date of the warrants, in which event it will expire upon the date which is 20 days following the date the Company provides written notice of the accelerated expiry to holders.

The agent will be paid 7% in cash commission and will be granted an option to purchase common shares equal to 7% of the number of units issued in the private placement with the option expiring 18 months from the closing date.